AN ANALYSIS OF THE PRESIDENT'S BUDGETARY PROPOSALS FOR FISCAL YEAR 1996

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in Chapter 2 are calendar years, and all years in other chapters and Appendixes A and B are fiscal years.

Unemployment rates throughout the report are calculated on the basis of the civilian labor force.

Numbers in the text and tables of this report may not add to totals because of rounding.

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Preface

This analysis of the President's budget for fiscal year 1996 was prepared at the request of the Senate Committee on Appropriations. The report discusses the President's policies in terms of changes from the Congressional Budget Office's (CBO's) baseline budget projections for 1996 through 2000. It provides estimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods.

The report was prepared by the staffs of the Budget Analysis, Macroeconomic Analysis, and Tax Analysis divisions under the supervision of Paul Van de Water, Robert Dennis, and Rosemary D. Marcuss. James Horney wrote Chapters 1 and 3, John Peterson wrote Chapter 2, and Frank Sammartino wrote Chapter 4. Appendix A was written by Jeffrey Holland, and Appendix B was written by Robert Dennis. The baseline revenue estimates were prepared under the direction of Richard A. Kasten. The estimates of the President's revenue proposals were prepared by the Joint Committee on Taxation. The principal contributors to the revenue and spending estimates and analyses are listed in Appendix C.

Paul L. Houts supervised the editing and production of the report. Major portions were edited by Paul L. Houts, Sherwood D. Kohn, Leah Mazade, Sherry Snyder, and Chris Spoor. Chris Spoor also provided editorial assistance during production. The authors owe thanks to Marion Curry, Dorothy Kornegay, Linda Lewis, L. Rae Roy, and Simone Thomas, who assisted in the preparation of the report. Kathryn Quattrone prepared it for final publication.

June E. O'Neill
Director

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Contents

TABLES

Chapter One

Summary and Introduction

The Congressional Budget Office (CBO) estimates that under the policies proposed in the President's budget for fiscal year 1996, deficits would increase from $177 billion in 1995 to $276 billion in 2000. Except for the current year, the estimates of deficits under the President's policies based on CBO's economic and technical assumptions are higher than those stated in the President's budget. CBO estimates that the deficit in 2000 would be $82 billion higher than the Administration projects.

The President's policies would not substantially change the deficits from the levels that would result under current laws and policies. An exact estimate of the change, however, depends on what assumption is made about the level of discretionary spending under current policy after the statutory limits on discretionary spending expire at the end of 1998. (CBO assumes that baseline discretionary spending will equal the limits in 1996 through 1998.) Compared with CBO's baseline projections that assume discretionary spending in 1999 and 2000 will equal the 1998 limit adjusted for inflation, the President's policies would reduce the cumulative deficits in 1995 through 2000 by almost $30 billion. Compared with CBO's baseline projections that assume discretionary spending in 1999 and 2000 will be at the same level as in 1998, the President's policies would increase the deficits over the next six years by about $31 billion.

In addition to reestimating the President's budget, CBO has revised the baseline projections published in its January report *The Economic and Budget Outlook: Fiscal Years 1996-2000* to take account of new information. Those revisions slightly reduce the projected baseline deficit for 1995 but increase the deficits after that by amounts growing from $3 billion in 1996 to $15 billion in 2000 (see Appendix A).

CBO has also revised the illustrative path to a balanced budget published in the January report and expanded its analysis of the economic benefits of moving toward a balanced budget in 2002 (see Appendix B). That analysis includes estimates of the revenue increases and net interest savings that would result over the next seven years from the economic improvements.

CBO's Reestimate of the President's Budgetary Proposals

CBO estimates that under the President's policies the deficit would increase from $177 billion in 1995 to $276 billion in 2000, or from 2.5 percent of gross domestic product (GDP) to 3.1 percent (see Table 1). CBO estimates that total outlays under the President's policies would grow at an average annual rate of almost 5 percent over the next five years--from $1,532 billion in 1995 to $1,954 billion in 2000. Revenues would grow a little more slowly, about 4.4 percent a year on average, and would increase from $1,355 billion in 1995 to $1,678 billion in 2000.

CBO's estimates of the deficits for 1996 through 2000 under the President's policies are higher than those projected by the Administration, which anticipates that the deficit will be essentially the same in

Table 1.
CBO's Budgetary Estimates Under the President's Policies (By fiscal year)

	Actual 1994	1995	1996	1997	1998	1999	2000
			In Billions of Dollars				
Revenues	1,258	1,355	1,416	1,464	1,534	1,604	1,678
On-budget	923	998	1,041	1,072	1,122	1,173	1,226
Off-budget	335	357	375	392	411	431	452
Outlays	1,461	1,532	1,626	1,696	1,765	1,860	1,954
On-budget	1,182	1,244	1,324	1,383	1,439	1,517	1,598
Off-budget	279	289	303	313	326	342	356
Deficit	203	177	211	232	231	256	276
On-budget deficit	259	246	283	311	316	344	372
Off-budget surplus	56	69	72	79	85	89	96
Debt Held by the Public	3,432	3,622	3,851	4,109	4,372	4,658	4,965
Memorandum:							
Gross Domestic Product	6,632	7,036	7,370	7,747	8,152	8,572	9,013
			As a Percentage of GDP				
Revenues	19.0	19.3	19.2	18.9	18.8	18.7	18.6
On-budget	13.9	14.2	14.1	13.8	13.8	13.7	13.6
Off-budget	5.1	5.1	5.1	5.1	5.0	5.0	5.0
Outlays	22.0	21.8	22.1	21.9	21.7	21.7	21.7
On-budget	17.8	17.7	18.0	17.9	17.6	17.7	17.7
Off-budget	4.2	4.1	4.1	4.0	4.0	4.0	4.0
Deficit	3.1	2.5	2.9	3.0	2.8	3.0	3.1
On-budget deficit	3.9	3.5	3.8	4.0	3.9	4.0	4.1
Off-budget surplus	0.8	1.0	1.0	1.0	1.0	1.0	1.1
Debt Held by the Public	51.7	51.5	52.3	53.0	53.6	54.3	55.1

SOURCE: Congressional Budget Office.

2000 as in 1995 (see Table 2). For 1995, however, CBO expects that the deficit will be lower than anticipated by the Administration. Most of CBO's reestimate of the deficits reflects differences between its and the Administration's projections of the revenues and outlays that would occur under current laws and policies. CBO separates its reestimates of the Administration's budget into two categories: those that result from differences in economic assumptions and those that result from technical estimating differences. For 2000, economic and technical reestimates are almost equally responsible for the $82 billion difference between CBO's estimate of the deficit under the President's policies and the Administration's estimate.

Economic Reestimates

The economic assumptions of CBO and the Administration appear quite similar. Yet the differences are sufficient to produce noticeable differences in budget projections. CBO's economic assumptions lower the projected deficits for 1995 and 1996 compared with the Administration's assumptions but raise the deficits thereafter. Although it assumes lower growth for the current year, the Administration foresees faster economic growth on average between now and 2000. It projects roughly the same rate of inflation as CBO and a marginally lower rate of unemployment after 1997.

In addition, the Administration forecasts somewhat higher interest rates than does CBO. The Administration and CBO (as well as the consensus of private-sector economists reflected in the *Blue Chip* survey) assume that the tightening of monetary policy over the past year will cause economic growth to slow from its pace of 1994. The forecasts differ somewhat, however, in the timing and degree of the slowdown. CBO (and the *Blue Chip* survey) anticipate significantly faster growth this year than next. The Administration assumes a smoother path with real (inflation-adjusted) growth of about 2½ percent in both 1995 and 1996.

Differences between CBO's economic forecast and that of the Administration push down CBO's projected revenues by more than $40 billion in 2000 compared with the Administration's estimates. CBO's lower projections of corporate profits reduce revenues in every year compared with the Administration's projections. CBO also projects lower imports than does the Administration, and the resulting lower estimate of customs duties holds CBO's estimate of other revenues below the Administration's in every year but 1995. CBO projects higher individual income than the Administration does through 1998 but lower income in 1999 and 2000. In 1995 and 1996, the higher individual income tax and social insurance receipts resulting from CBO's forecast for individual income more than offset the revenue effects of the other aspects of CBO's economic forecast. From 1997 on, however, CBO's economic forecast reduces revenues compared with the Administration's forecast.

CBO's economic assumptions also reduce its projection of spending compared with that of the Administration but by far less than the reduction in revenues. CBO's lower unemployment forecast pushes down its estimate of unemployment benefit payments by $1 billion in 1995 and 1996. But after that, less than $500 million of the difference between CBO's and the Administration's projections of unemployment costs in any year is the result of differences in economic assumptions. Because it projects a more rapid increase in the consumer price index, CBO estimates that the costs of other benefit programs (Social Security and other programs with automatic cost-of-living adjustments) will be higher. CBO's projection of interest payments is below the Administration's, since CBO assumes lower interest rates.

Technical Reestimates

Estimating differences unrelated to economic assumptions add to CBO's estimates of the deficits under the President's budgetary policies compared with the Administration's estimates over the 1996-2000 period. Excluding economic differences, CBO's projection of revenues in 2000 is about $8 billion higher than the Administration's, but CBO's projection of spending is $50 billion higher. Nearly half of the difference in projected spending can be found in the Medicare and Medicaid programs. Although CBO believes that the growth of those programs has

Table 2.
CBO's Reestimates of the President's Budgetary Proposals (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000
Deficit Under the President's Budgetary Proposals as Estimated by the Administration	193	197	213	196	197	194
Economic Reestimates						
Revenues[a]						
Individual income and social insurance taxes	-15	-13	-9	-4	4	7
Corporate profits taxes	3	8	13	14	17	22
Other	b	1	4	7	9	11
Subtotal	-13	-4	8	17	29	41
Outlays						
Unemployment compensation	-1	-1	b	b	b	b
Other benefit programs	b	b	1	2	3	5
Net interest	b	1	-3	-7	-7	-6
Other	b	b	b	b	b	b
Subtotal	-1	b	-2	-5	-4	-1
Total, economic reestimates	-13	-4	5	12	25	40
Technical Reestimates						
Revenues[a]						
Individual income and social insurance taxes	b	3	1	-1	-6	-7
Corporate profits taxes	-1	-2	-2	-3	-5	-5
Other	4	2	2	2	3	4
Subtotal	4	4	b	-2	-8	-8
Outlays						
Medicaid	1	3	5	7	10	12
Medicare	4	4	6	7	9	11
FCC spectrum auctions	-5	3	1	2	b	-1
Unemployment compensation	1	1	1	2	2	3
Housing assistance	b	1	2	5	9	10
Deposit insurance	-3	-1	-3	-6	-2	1
Net interest	1	2	4	5	6	8
Other	-3	1	-3	3	7	7
Subtotal	-6	15	14	25	41	50
Total, technical reestimates	-2	18	14	23	33	42
Total Reestimates	-16	14	19	35	58	82
Deficit Under the President's Budgetary Proposals as Estimated by CBO	177	211	232	231	256	276

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTE: FCC = Federal Communications Commission.

a. Revenue reductions are shown as positive because they increase the deficit.

b. Less than $500 million.

slowed from the extremely high rates of recent years, it is not quite as optimistic as the Administration about the slowdown. Given the size of those two programs and the uncertainty about their future costs, the projections of CBO and the Administration are not very far apart.

CBO and the Administration differ in their assumptions about the timing of proceeds from auctioning portions of the electromagnetic spectrum by the Federal Communications Commission. In estimating spending for unemployment compensation, CBO assumes that average benefits will be higher than the Administration projects. CBO's reestimate of net outlays by deposit insurance agencies reflects both its more optimistic outlook about future failures of banks and thrift institutions and its higher estimate of proceeds from the sale of assets acquired by the government as a result of previous thrift failures. Another difference between CBO and the Administration is in the estimates of discretionary spending for housing assistance programs. However, the Department of Housing and Urban Development is in the process of revising and updating the Administration's assisted housing proposals, which may significantly reduce the difference between CBO's and the Administration's estimates in this area. The difference in projected net interest costs primarily reflects the debt service on the increase in the projected deficits that result from other technical reestimates.

CBO's Estimate of the Effects of the President's Budgetary Proposals

CBO estimates that enacting the President's budgetary proposals would not significantly change the deficits from the levels it projects under current laws and policies (see Table 3). The President's proposed changes in nondiscretionary spending and revenues would increase the deficit by almost $40 billion over the 1995-2000 period, but the discretionary appropriations proposed in the budget are below CBO's projections of discretionary spending under current policies. How much of a reduction the discretionary proposals represent--as well as CBO's estimate of the net effect on the deficits of all of the President's policies--depends on assumptions about discretionary spending in 1999 and 2000.

The President has proposed tax measures that would shrink revenues by almost $60 billion over the 1995-2000 period and by $20 billion in 2000. Proposed savings in Medicare (stemming primarily from extending provisions of the Omnibus Budget Reconciliation Act of 1993 that expire at the end of 1998) and other mandatory programs offset only about $17 billion of the revenue loss over the six-year period and $8 billion of the loss in 2000. The President has also proposed to sell assets that CBO estimates would produce almost $8 billion in income. Other proposals would increase nondiscretionary spending (other than net interest) by almost $4 billion.

Assessing the change in the deficit that can be attributed to the President's discretionary spending proposals is not so straightforward because proposed discretionary spending can be measured against two different baselines. The two baselines are the same through 1998: both include CBO's estimate of discretionary spending in 1995 from already enacted appropriations, and both assume that discretionary spending for 1996 through 1998 will equal the statutory limits on such spending contained in the Balanced Budget and Emergency Deficit Control Act of 1985 (the Balanced Budget Act). After 1998--the last year that the statutory limits are in effect--one baseline assumes that discretionary spending equals the 1998 limit adjusted for inflation. The other assumes that there is no adjustment for inflation after 1998--in other words, that discretionary spending in 1999 and 2000 will be the same in nominal terms as in 1998.

According to CBO's estimates, the President's proposals would result in discretionary spending that ranges from $550 billion in 1995 to $561 billion in 2000. Compared with CBO's baseline with discretionary inflation after 1998, the President's proposals would reduce discretionary spending by $67 billion in 1995 through 2000, with most of the reductions in the last two years. Those savings more than offset the deficit increases that result from the President's revenue and mandatory spending proposals and produce net deficit reduction of almost $30 billion in the 1995-2000 period. Compared with CBO's baseline without discretionary inflation, the President's pro-

Table 3.
CBO's Estimates of the President's Budgetary Proposals (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000
Changes from CBO's Baseline With Discretionary Inflation After 1998						
CBO's Baseline Deficit With Discretionary Inflation After 1998[a]	175	210	230	232	266	299
President's Budgetary Proposals						
Pay-as-you-go						
Revenues[b]	c	2	11	13	15	20
Outlays	0	c	-1	-2	-5	-8
Subtotal	c	2	10	11	9	11
Asset sales[d]	0	-1	-4	-3	0	0
Discretionary appropriations	2	-1	-5	-9	-21	-34
Other outlays	c	c	c	1	1	1
Debt service	c	c	c	c	c	-2
Total Changes	2	1	2	-1	-11	-23
Deficit Under the President's Budgetary Proposals as Estimated by CBO	177	211	232	231	256	276
Changes from CBO's Baseline Without Discretionary Inflation After 1998						
CBO's Baseline Deficit Without Discretionary Inflation After 1998[e]	175	210	230	232	247	258
President's Budgetary Proposals						
Pay-as-you-go						
Revenues[b]	c	2	11	13	15	20
Outlays	0	c	-1	-2	-5	-8
Subtotal	c	2	10	11	9	11
Asset sales[d]	0	-1	-4	-3	0	0
Discretionary appropriations	2	-1	-5	-9	-2	4
Other outlays	c	c	c	1	1	1
Debt service	c	c	c	c	1	2
Total Changes	2	1	2	-1	9	18
Deficit Under the President's Budgetary Proposals as Estimated by CBO	177	211	232	231	256	276

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

a. Projections assume discretionary spending is equal to the spending limits that are in effect through 1998 and is equal to the 1998 limit adjusted for inflation after that.

b. Revenue reductions are shown as positive because they increase the deficit.

c. Less than $500 million.

d. Under current law, proceeds from asset sales are not counted for purposes of the Congressional Budget Act or the Balanced Budget and Emergency Deficit Control Act enforcement procedures. The President has proposed that the proceeds from the sales in his budget should be counted for those purposes.

e. Projections assume discretionary spending is equal to the spending limits that are in effect through 1998 and is equal to the 1998 limit after that.

posals would reduce discretionary spending over those six years by only about $10 billion. Because those cuts are not enough to offset the increases in the deficit resulting from other proposals, the deficits under the President's policies represent an increase of about $31 billion in 1995 through 2000 compared with the deficits projected in this baseline.

CBO estimates that the President's mandatory spending and revenue proposals would add more than $22 billion in deficit increases to the pay-as-you-go scorecard in 1995 through 1998 (the pay-as-you-go procedures of the Balanced Budget Act are scheduled to expire after 1998). The President has recommended disposing of assets that CBO estimates would sell for nearly $8 billion. Under current law, those proceeds would not count for pay-as-you-go purposes, but the President has proposed that the law be changed to allow the asset sales to be counted.

In addition, the Administration asserts that a proposed reduction in the discretionary spending limits (to the levels of discretionary spending in the President's budget) should be counted as pay-as-you-go savings. Based on CBO's estimates, total nonemergency discretionary spending proposed by the President is $20 billion below the current limits for 1996 through 1998. CBO believes, however, that the current budget enforcement process reflects a clear decision by lawmakers that discretionary spending should be subject to different budgetary control mechanisms than would be applied to mandatory spending and receipts. Therefore, in CBO's view, reductions in the discretionary spending limits cannot be included in the pay-as-you-go scorecard without a change in law.

Most of the supposed savings in discretionary spending result from an increase in the discretionary appropriation limits made by the Office of Management and Budget (OMB) in the sequestration preview report included in the President's budget. OMB interpreted a provision of the Omnibus Budget Reconciliation Act of 1993 as allowing a new method of calculating the required adjustment to the limits for changes in inflation. Instead of continuing to adjust the limits for the difference between actual inflation experienced in the most recently completed fiscal year (1994 in this instance) and the inflation anticipated for that year when the limits were set, OMB adjusted for the differences between its current forecast of inflation for 1996, 1997, and 1998 and the inflation forecast for those years when the limits were set.

CBO estimates that the change in method increased the limits by almost $16 billion in 1996 through 1998. Although CBO believes that OMB's interpretation of the law is incorrect, CBO will continue to use OMB's limits in its baseline budget projections. Therefore, CBO's estimates of the President's budget show savings in discretionary spending compared with OMB's official estimate of the limits through 1998. CBO's estimated savings in discretionary spending after 1998 also reflect the higher OMB limits because CBO's baseline projections of discretionary spending in those years take the 1998 limit as their starting point. If CBO had not adjusted its baseline estimates of discretionary spending to conform to OMB's official limits, CBO's estimate of discretionary savings proposed in the President's budget would have been significantly smaller. Moreover, CBO's estimate of the overall effect of the President's policies would have shown an increase in total deficits over the 1995-2000 period, even when compared with CBO's baseline that includes discretionary inflation after 1998.

Chapter Two

Comparison of Economic Forecasts

The economic assumptions of the Clinton Administration and the Congressional Budget Office are similar. The differences, however, are sufficient to raise the Administration's projections of the deficit for 1995 and 1996 slightly above CBO's and to lower them for 1997 through 2000. The Administration foresees slower growth for 1995 but faster growth on average between 1996 and 2000. It also projects roughly the same rate of inflation overall, a marginally lower rate of unemployment, and higher interest rates. In addition, the Administration's forecast for the share of gross domestic product subject to taxation is slightly lower than CBO's for the near term but is higher for 1997 through 2000.

The Administration's economic assumptions incorporate the effects of its 1996 budget proposal, whereas CBO's forecast and projections are based on current law. The Administration's budget does not differ greatly from current law, however, as far as its effect on the overall economy is concerned, so the difference in assumptions about fiscal policy is not a cause of differences in the economic assumptions.

The Short-Term Outlook, 1995-1996

The differences between the Administration's and CBO's forecasts do not affect the short-term deficit outlook significantly. The Administration assumes, as do CBO and economists generally, that the economy is at a high rate of resource use and that inflationary pressures are building. Furthermore, CBO, the Administration, and a consensus of private-sector economists reflected in the *Blue Chip Economic Indicators* all expect that the tightening of monetary policy over the past year will ultimately cause the economy to cool. The three forecasts differ, however, in the timing and degree of the slowdown. CBO and the *Blue Chip* anticipate about 3 percent growth in 1995 and significant slowing next year, although CBO is more pessimistic than the *Blue Chip* for 1996. In contrast, the Administration assumes less growth this year and little further slowing in 1996 (see Table 4).

Other differences among the three short-term forecasts are also slight. The *Blue Chip* foresees higher inflation in 1996 than do the other two and, consequently, higher interest rates as well. The Administration's forecast for inflation and interest rates is similar to CBO's.

The Outlook for the Projection Period, 1997-2000

The Administration expects faster growth on average, a different pattern of price change, and higher interest rates than does CBO for 1997 through 2000. The average growth of real GDP is 0.2 percentage points per year greater than CBO's. Both the Administration and CBO assume an average unemployment rate of just below 6 percent for the period. The implicit GDP deflator grows faster in the Administration's outlook than in CBO's by about 0.2 percentage points, but CBO's projections for inflation as measured by the consumer price index (CPI) are higher by about 0.2 percentage points. Finally, the Administration projects higher nominal interest rates.

The Administration is generally closer than CBO to the *Blue Chip's* long-range projections. The *Blue Chip* indicates the same average growth over the 1997-2000 period as the Administration and has similar projections for interest rates and the GDP deflator. Only in its projections for the CPI is the *Blue Chip* significantly closer to CBO's projection than to the Administration's.

Real Growth

Real growth over the 1997-2000 period averages 2.5 percent in the Administration's projection, compared with 2.3 percent in CBO's. A useful way to compare

Table 4.
Comparison of Congressional Budget Office, Administration, and *Blue Chip* Economic Projections, Calendar Years 1994-2000

	Actual 1994	Forecast 1995	Forecast 1996	Projected 1997	Projected 1998	Projected 1999	Projected 2000
Nominal GDP (Billions of dollars)							
CBO	6,735	7,127	7,456	7,847	8,256	8,680	9,128
Administration	6,735	7,117	7,507	7,921	8,361	8,832	9,310
Real GDP[a] (Percentage change, year over year)							
CBO	4.0	3.1	1.8	2.4	2.3	2.3	2.3
Administration	4.0	2.8	2.5	2.5	2.5	2.5	2.5
Blue Chip	4.0	3.2	2.2	2.0	2.3	2.9	2.8
GDP Deflator (Percentage change)							
CBO	2.1	2.6	2.8	2.8	2.8	2.8	2.8
Administration	2.1	2.8	3.0	3.0	3.0	3.0	3.0
Blue Chip	2.1	2.6	3.2	3.3	3.1	3.0	3.0
Consumer Price Index[b] (Percentage change, year over year)							
CBO	2.6	3.1	3.4	3.4	3.4	3.4	3.4
Administration	2.6	3.1	3.2	3.2	3.2	3.1	3.1
Blue Chip	2.6	3.2	3.6	3.4	3.4	3.4	3.4
Civilian Unemployment Rate (Percent)							
CBO	6.1	5.5	5.7	5.8	5.9	6.0	6.0
Administration	6.1	5.8	5.9	5.8	5.8	5.8	5.8
Blue Chip	6.1	5.5	5.7	6.0	6.2	6.0	5.8

(Continued)

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (March 10, 1995).

NOTE: GDP = gross domestic product.